

**Letter of Findings Number: 03-0360**  
**Income Tax**  
**For Tax Years 1999-2001**

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**ISSUE**

**I. Gross Income Tax—Partnership Income**

**Authority:** [IC 6-2.1-2-2](#); [45 IAC 1.1-2-1](#)

Taxpayer protests the imposition of gross income tax on income from its ownership of rental property.

**II. Adjusted Gross Income Tax—Partnership Income**

**Authority:** [45 IAC 3.1-1-55](#)

Taxpayer protests the imposition of adjusted gross income tax on income from its ownership of rental property.

**III. Tax Administration—Negligence Penalty**

**Authority:** [IC 6-8.1-10-2.1](#); [45 IAC 15-11-2](#)

Taxpayer protests the imposition of a ten percent negligence penalty and interest.

**STATEMENT OF FACTS**

Taxpayer is an Ohio company which is a partner in a partnership which owns an apartment complex in Indiana. As the result of an audit, the Indiana Department of Revenue ("Department") issued proposed assessments for gross income tax, adjusted gross income tax and a ten percent negligence penalty. Taxpayer agrees with some of the adjustments and protests other adjustments. Further facts will be supplied as required.

**I. Gross Income Tax—Partnership Income**

**DISCUSSION**

Taxpayer protests the imposition of gross income tax on an asset management fees received by the taxpayer from the Indiana partnership. The relevant statute in effect at the time (Indiana has since repealed the gross income tax) was [IC 6-2.1-2-2\(a\)](#) which states:

An income tax, known as the gross income tax, is imposed upon the receipt of:

- (1) the entire taxable gross income of a taxpayer who is a resident of Indiana; and
- (2) the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana.

Since taxpayer is not a resident or domiciliary of Indiana, [IC 6-2.1-2-2\(a\)\(2\)](#) imposes gross income tax on taxable gross income derived from activities or businesses or any other sources within Indiana.

[45 IAC 1.1-2-1](#) states in relevant part:

(a) Except as otherwise provided in this article or [IC 6-2.1](#), the gross income tax is imposed upon the receipt of:

- (1) the entire gross income of a taxpayer who is a resident or a domiciliary of Indiana; and
- (2) the gross income derived from an activity, a business, or another source within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana.

Section 5.5(a) of the partnership agreement states in relevant part:

Provided that the Project is in compliance for purposes of the Low Income Housing Tax Credit, the Partnership shall also pay an asset management fee to the General Partner equal to 2.5 [percent] of the gross receipts, paid quarterly, commencing January 1, 1995;

None of the evidence available to the Department indicates that the activities associated with taxpayer's duties to keep the project (the apartment complex) in compliance with the Low Income Housing Tax Credit took place anywhere other than at taxpayer's Ohio headquarters. Under [45 IAC 1.1-2-1\(a\)\(2\)](#), since the gross income was not derived from an activity within Indiana, it is not subject to Indiana gross income tax.

**FINDING**

Taxpayer's protest is sustained.

**II. Adjusted Gross Income Tax—Partnership Income**

**DISCUSSION**

Taxpayer protests several adjustments the Department made to adjusted gross income tax. Taxpayer protests that the Department used an incorrect number when calculating the sales factor denominator. Upon review, an incorrect number was used and this error will be corrected. Taxpayer also protests deductions from the payroll factor calculation. The Department considered the employees at the apartment complex to be employees of the property manager and removed the amount paid to those employees from both the numerator and denominator of the payroll factor calculation. Upon further review of the management agreement, Section 3(c)

states that all employees at the apartment complex are employees of the owner (taxpayer) and not the agent.

Taxpayer also protests the inclusion of the asset management fee described in Issue I in the numerator of the sales factor. The asset management fee was paid when taxpayer ensured that the project (the apartment complex) was in compliance with the Low Income Housing Tax Credit. The activities associated with ensuring compliance were performed at taxpayer's Ohio headquarters, not the apartment complex. [45 IAC 3.1-1-55](#) states in relevant part:

Gross receipts from transactions other than sales of tangible personal property shall be included in the numerator of the sales factor if the income-producing activity which gave rise to the receipts is performed wholly within this state. Except as provided below if the income producing activity is performed within and without this state such receipts are attributed to this state if the greater proportion of the income producing activity is performed here, based on costs of performance.

Since the income producing activities were not performed wholly within Indiana, the gross receipts should not be included in the numerator of the sales factor.

In conclusion, the Department agrees that the error in the sales factor denominator should be corrected. The asset management fee should not be included in the sales factor numerator, as provided in [45 IAC 3.1-1-55](#). The wages paid to employees of the apartment complex should be included in the numerator and denominator of the payroll factor calculations.

#### FINDING

Taxpayer's protest is sustained.

### III. Tax Administration—Negligence Penalty and Interest

#### DISCUSSION

Taxpayer protests that the amount of penalty and interest should be adjusted after adjustments are made pursuant to the outcome of Issues I and II. The Department refers to [IC 6-8.1-10-2.1\(a\)](#), which states in relevant part:

If a person:

...

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

...

the person is subject to a penalty.

The Department refers to [45 IAC 15-11-2\(b\)](#), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

[45 IAC 15-11-2\(c\)](#) provides in pertinent part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer incurred other unprotested deficiencies which the Department determined was due to negligence under [45 IAC 15-11-2\(b\)](#), and so was subject to a penalty under [IC 6-8.1-10-2.1\(a\)](#). Taxpayer has not affirmatively established by documentation and explanation that there was no failure to pay the unprotested deficiencies, as required by [45 IAC 15-11-2\(c\)](#). The negligence penalty and interest shall not be waived, but shall be recalculated after adjustments are made pursuant to the sustainment of taxpayer's protests in Issues I and II.

#### FINDING

Taxpayer's protest is sustained to the extent that penalty and interest will be recalculated after the adjustments in Issues I and II are made.

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